

Macy's Miracle on 34th Street:¹ Employing Mediation to Develop the Reorganization Plan in a Mega-Chapter 11 Case

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I. INTRODUCTION

Historically, bankruptcy courts have operated efficiently and effectively. After a wave of filings in the 1980s, however, some commentators argued that reform was needed to change the way in which bankruptcy disputes were handled.² As a result, in the mid-1980s, alternative dispute resolution (ADR) made a visible impact on the bankruptcy scene. The use of ADR in bankruptcy has increased in recent years³ because debtors and creditors recognize ADR as a viable alternative to the long, arduous, litigious struggles they usually face. Although the use of arbitration is prominent in the bankruptcy field, the use of mediation to formulate reorganization plans is controversial.⁴ Despite this controversy, mediation is becoming firmly established in the bankruptcy field as an important component in many reorganization cases.

As an increasing number of corporations seek Chapter 11⁵ protection each year,⁶ mediation provides a valuable alternative to litigation for

¹ VALENTINE DAVIES, *MIRACLE ON 34TH STREET* (1st ed. 1947). Macy's Herald Square store was featured in *Miracle on 34th Street*. See *MIRACLE ON 34TH STREET* (Twentieth Century Fox Film Corp. 1991) (a release of the 1947 motion picture). The film classic, based on Valentine Davies' story, depicts the grandiose Macy's of an earlier era and stars Edmund Gwenn, Natalie Wood, Maureen O'Hara, and John Payne. See *id.* The screenplay was written by George Seaton. See GEORGE SEATON, *BEST AMERICAN SCREENPLAYS, FIRST SERIES: COMPLETE SCREENPLAYS* (Sam Thomas ed., 1986).

² See Mary A. Bedikian, *Using ADR to Resolve Bankruptcy Claims*, DISP. RESOL. J., Dec. 1993, at 25 (explaining that the 1982 recession caused many individuals and corporations to file for bankruptcy protection).

³ See Lillian E. Kraemer & Thomas C. Rice, *The Evolving Examiner: Different Role Has Emerged*, N.Y.L.J., Feb. 3, 1997, at 7 (recognizing the popular trend towards ADR).

⁴ See discussion *infra* Part II.B.

⁵ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (current version at 11 U.S.C. (1994)). Chapter 11 is a reorganization chapter that allows debtors to pay creditors over an extended period of time. For an extensive discussion of Chapter 11, see KAREN GROSS, *FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM* 31-40 (1997).

satisfying the demands on the bankruptcy system. By removing cases from the courts' dockets, mediation helps reduce the courts' caseloads,⁷ thereby expediting the judicial process. Additionally, by reducing the courts' caseloads, mediation also serves to improve judicial economy within the bankruptcy system. For these reasons, many bankruptcy courts are referring cases to mediation.⁸

More specifically, the Bankruptcy Court for the Southern District of New York has recognized the advantages of mediation by utilizing the process in many of its Chapter 11 cases. For example, R.H. Macy & Co., Inc. (Macy's)⁹ filed for Chapter 11 protection on January 27, 1992.¹⁰ In light of the fact that Macy's needed a near miracle to emerge both independent and reorganized,¹¹ the reorganization was forecasted to be a lengthy and laborious struggle. Undoubtedly, the district court wanted to avoid a repeat of the LTV Steel Co., Inc. bankruptcy saga that had occupied the court for seven years.¹² So after nearly two years of fruitless

⁶ From October 1, 1990 to September 30, 1991, there were 20,394 Chapter 11 filings, which represents a 14% increase from the 17,789 filings for the previous 12-month period. See Michelle M. Arnopol, *Why Have Chapter 11 Bankruptcies Failed So Miserably? A Reappraisal of Congressional Attempts to Protect a Corporation's Net Operating Losses After Bankruptcy*, 68 NOTRE DAME L. REV. 133, 136 (1992).

⁷ See *id.* The total number of bankruptcies filed each year is even more astounding. In 1992, 970,000 new bankruptcy cases were filed, which marked the eighth consecutive year for record filings. Of the total number of bankruptcy filings, the State of New York had 52,095, up 14% from the previous year. See Barbara Franklin, *ADR Meets Bankruptcy: Experts Explore Ways to Abbreviate the Process*, N.Y.L.J., Apr. 22, 1993, at 5.

⁸ For a discussion of the emergence and development of mediation in bankruptcy courts, see *infra* Part II.

⁹ Macy's was founded in 1858 and incorporated in New York in 1919. See R.H. Macy & Co., Inc., *Plans of Reorganization*, The Bankruptcy Datasource, Aug. 15, 1994, available in 1994 WL 459553 [hereinafter R.H. Macy, *Plans of Reorganization*].

¹⁰ See *In re R.H. Macy & Co.*, 152 B.R. 869, 870-871 (Bankr. S.D.N.Y. 1993). Macy's is considered a "mega" Chapter 11 case because it involved more than \$100 million in assets. See GROSS, *supra* note 5, at 31. Other well-known companies involved in mega-Chapter 11 cases have included Dow Corning, Olympia & York, Continental Airlines, Alexander's, Child World, Texaco, TWA, Revco, Federated, Orion Pictures, and Pan Am. See *id.*

¹¹ See David Moin & Rich Wilner, *Macy's Claims Independence, but Talks Go On*, WOMEN'S WEAR DAILY, June 14, 1994, at 2, available in 1994 WL 3053237 (noting Macy's desire to emerge from Chapter 11 as an independent company).

¹² LTV filed for Chapter 11 protection on July 16, 1986, in the Bankruptcy Court for the Southern District of New York. See Janice L. Green, *CERCLA and the Bankruptcy Code*, 11 TEMP. ENVTL. L. & TECH. J. 171, 174 (1992). Seven years later,

bankruptcy proceedings, Judge Burton R. Lifland, the bankruptcy judge in charge of Macy's case, appointed a mediator to coordinate Macy's reorganization.¹³ Judge Lifland's move shocked the bankruptcy world.¹⁴ Could mediation provide the miracle Macy's so desperately needed?

Part II of this Note documents the courts' authority to refer cases to mediation and how such referrals effectuate the goals of both mediation and bankruptcy law. Part II also describes the efforts of several bankruptcy courts to elevate mediation to a prominent position in the bankruptcy world. Part III provides a critical analysis of the controversy surrounding the use of mediation in bankruptcy, especially in the formulation of reorganization plans. Part IV analyzes Macy's use of mediation in the formulation of its reorganization plan and details the results of the process. Ultimately, Part V concludes that the success of Macy's mediation will undoubtedly prompt other courts to consider mediation as a viable alternative to litigation in Chapter 11 proceedings.

II. THE EMERGENCE OF MEDIATION IN BANKRUPTCY

The evolution of mediation into an important bankruptcy tool is attributable to the authoritative bases that allow such development and the diligent efforts of several bankruptcy courts. Several sources enable bankruptcy courts to utilize mediation. While the purpose of this Note is not to provide an in-depth examination of the authority for mediation in bankruptcy,¹⁵ the two main sources of authority for the use of the

and after accumulating \$200 million in professional fees, the LTV bankruptcy was resolved. *See* Allan Sloan, *Bosnia Seems to Make More Sense than Cy Vance as Macy's Mediator*, WASH. POST, March 1, 1994, at D3. Interestingly, the average length of a Chapter 11 proceeding is more than 17 months. *See* Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85, 89-90 (1995).

¹³ Judge Lifland appointed former Secretary of State Cyrus Vance to oversee Macy's reorganization efforts. *See* JEFFREY A. TRACHTENBERG, *THE RAIN ON MACY'S PARADE: HOW GREED, AMBITION, AND FOLLY RUINED AMERICA'S GREATEST STORE* 229 (1996).

¹⁴ *See id.* at 229-230; *see also infra* Part II.B.

¹⁵ For an extensive discussion of the authority for the use of ADR in bankruptcy, *see* Ralph R. Mabey et al., *Expanding the Reach of Alternative Dispute Resolution in Bankruptcy: The Legal and Practical Bases for the Use of Mediation and the Other Forms of ADR*, 46 S.C. L. REV. 1259 (1995). In short, the sources include the courts' inherent power to manage and control their dockets, the statutes enabling the district courts to use ADR through local district court rules, section 105 of the Bankruptcy Code, sections 1104 and 1106 of the Bankruptcy Code authorizing the use of examiners,

process—federal statutory authority and inherent authority—will be briefly discussed. Many bankruptcy courts followed the lead of the Bankruptcy Court for the Southern District of California by employing these authoritative sources to create their own court-annexed mediation programs. As the benefits of mediation in bankruptcy cases gain greater recognition, courts will increasingly use mediation to relieve their congested dockets and improve judicial economy.

A. Authority for Mediation in Bankruptcy

An important federal statute that provides authority for the use of ADR in the federal courts is the Civil Justice Reform Act of 1990.¹⁶ In accordance with this statute, many federal courts, including both district courts and bankruptcy courts, have developed local ADR rules.¹⁷ The Act specifically refers to mediation as a form of ADR.¹⁸ In light of the fact that the Act directs courts to use ADR to expedite civil case proceedings,¹⁹ judges began experimenting with the various forms of ADR. By virtue of this experimentation, many bankruptcy judges noticed the benefits of ADR and began utilizing ADR in civil cases because ADR offers “a more efficient resolution of controversies and disputes than litigation in the bankruptcy court.”²⁰ By expediting the normally lengthy period between

section 1123 of the Bankruptcy Code, local bankruptcy court rules, and Bankruptcy Rule 7016. *See id.* at 1283.

¹⁶ *See* WILLIAM L. NORTON, JR., *NORTON BANKRUPTCY LAW AND PRACTICE* § 146:1 (2d ed. 1997); *see also* 28 U.S.C. §§ 471–482 (1994). The Act directs that district courts refer appropriate cases to ADR. *See id.* § 473(a)(6)(B). The reference to district courts encompasses the bankruptcy courts because the bankruptcy courts are considered arms of the district courts. *See* Lisa A. Lomax, *Alternative Dispute Resolution in Bankruptcy: Rule 9019 and Bankruptcy Mediation Programs*, 68 AM. BANKR. L.J. 55, 81–82 (1994). *But see* Kim Dayton, *The Myth of Alternative Dispute Resolution in the Federal Courts*, 76 IOWA L. REV. 889, 957 (1991) (claiming that in enacting the Civil Justice Reform Act, “Congress has swallowed so completely the myth of ADR in federal courts,” even though “the statistics simply do not support the claims” of ADR’s value).

¹⁷ *See* NORTON, *supra* note 16, § 146:1.

¹⁸ *See* 28 U.S.C. § 473(a)(6)(B) (listing mediation, minitrial, and summary jury trial as possible forms of ADR).

¹⁹ *See* Franklin, *supra* note 7, at 5.

²⁰ *Id.* (quoting F. Stephen Knippenberg, Professor of Law at the University of Oklahoma, who serves as a reporter to a subcommittee of the Bankruptcy Committee of the Judicial Conference of the United States); *see also* Bedikian, *supra* note 2, at 25

the bankruptcy filing and the confirmation of the reorganization plan,²¹ ADR reduces the costs of a Chapter 11 resolution.

In addition to statutory authority, the bankruptcy courts arguably possess inherent authority to require parties to utilize ADR when it serves the needs of the case, the parties, and judicial economy.²² Mediation allows courts to “manage their own affairs so as to achieve the orderly and expeditious disposition of cases.”²³ Mediation is particularly well-suited for resolving bankruptcy disputes because the goals of mediation and bankruptcy law²⁴ are complementary. These complementary goals strengthen the argument that the courts have inherent authority to use mediation because the goals are aimed at serving the needs of the case, the parties, and judicial economy.

For example, a main goal of bankruptcy law is to “maximize the value of the estate for the benefit of the creditors”²⁵ as quickly as possible. More specifically, in a Chapter 11 case, bankruptcy law is designed to rehabilitate the debtor. Mediation furthers these goals by offering the parties “a confidential, non-confrontational means of resolving disputes without the expense and business consequences of protracted litigation.”²⁶ The process also “saves precious time, priceless energy and preserves the integrity of relationships.”²⁷ Specifically in the Chapter 11 context,

(stating that the benefits of ADR include refocusing hostility and expediting proceedings).

²¹ See Franklin, *supra* note 7, at 5.

²² See Mabey et al., *supra* note 15, at 1286. Several courts have held that federal courts possess inherent authority to compel parties to participate in ADR. See Dayton, *supra* note 16, at 944 & n.259.

²³ Mabey et al., *supra* note 15, at 1284 (citing *Link v. Wabash R.R.*, 370 U.S. 626, 630–631 (1962)).

²⁴ A successful bankruptcy mediation program should reduce the time spent in litigation, increase chances of successful reorganization, provide a “fresh start,” prevent wasteful expenditures, and provide for an equitable distribution to creditors. See Lomax, *supra* note 16, at 88.

²⁵ Catherine M. DiDomenico, *Mediation in Bankruptcy Court*, N.Y.L.J., Apr. 11, 1997, at 1; see also Lomax, *supra* note 16, at 56 (noting that “[u]nnecessary delay, expense, and duplication of effort are abhorred in the bankruptcy context because of the limited resources available to spend on judicial proceedings”); Rasmussen & Skell, *supra* note 12, at 86 (adding that the goals of bankruptcy law must be accomplished as cheaply as possible).

²⁶ DiDomenico, *supra* note 25, at 1.

²⁷ Sid Stahl, *Legal Landscape in Texas Encourages ADR*, ALTERNATIVES TO HIGH COST LITIG., Mar. 1994, at 33 (quoting Anne Packer, presiding judge of Texas’s Civil District Court in Dallas); see also Lomax, *supra* note 16, at 56 (noting that the goals of

bankruptcy law requires consensual plans of reorganization.²⁸ Mediation fosters this goal because the mediator helps parties understand each other's position in an effort to come to a consensual resolution of the dispute.²⁹ In fact, many courts use mediation to formulate consensual plans of reorganization.³⁰ In light of the semblance between the goals of mediation and bankruptcy law, mediation is a natural means of formulating reorganization plans. Although there remains some controversy whether bankruptcy courts possess the inherent authority to use mediation,³¹ many courts are increasingly utilizing the process to control their dockets.

B. *Mediation's Development in the Bankruptcy Courts*

In 1986, the Bankruptcy Court for the Southern District of California established the first mediation program for bankruptcy proceedings.³² By

debtor rehabilitation and maximum distribution to creditors are frustrated by protracted bankruptcy proceedings).

²⁸ See Irvin W. Sandman, *Should Bankruptcy Lawyers Resist Mediation?*, 14 AM. BANKR. INST. J. 26, 26 (1995).

²⁹ See DiDomenico, *supra* note 25, at 1. One source refers to mediation as "supercharged negotiations":

Because an agreed settlement is mediation's goal, the process is intended to help the parties reach that goal more effectively and with less waste than alternative processes. . . . [T]he mediator does not render a "decision" and has no power to force a settlement on the parties. As a result, the parties do not spend time trying to control what the mediator will do "to" them. Instead, each party uses the mediator and the process to achieve the party's settlement objectives.

Sandman, *supra* note 28, at 26. For a comprehensive view of the mediator's role, see C. MOORE, *THE MEDIATION PROCESS* (1986).

³⁰ See Hon. Nancy F. Atlas, *Mediation in Bankruptcy Cases (Part I)*, PRAC. LAW., Sept. 1995, at 39, 40 [hereinafter Atlas, *Part I*]. See *infra* Part IV for a comprehensive look at how the Southern District of New York used mediation in formulating Macy's reorganization plan.

³¹ See Lomax, *supra* note 16, at 83 & n.176 (noting that the Sixth Circuit has held that the court lacks inherent authority to compel a summary jury trial over the objection of a party).

³² See NORTON, *supra* note 16, § 146:2; see also Lomax, *supra* note 16, at 70. The California project was originated by a group of bankruptcy attorneys motivated by crowded court dockets and significant delays in bankruptcy resolutions. See NORTON, *supra* note 16, § 146:2. For an extensive discussion of the Southern District of California's mediation program, see STEVEN HARTWELL & GORDON BERMANT, *ALTERNATIVE DISPUTE RESOLUTION IN A BANKRUPTCY COURT: THE MEDIATION PROGRAM IN THE SOUTHERN DISTRICT OF CALIFORNIA* (1988).

1988, the Bankruptcy Court for the Middle District of Florida had begun its journey into the realm of mediation.³³ The Bankruptcy Court for the Eastern District of Virginia adopted its mediation program in 1992.³⁴ In October 1995, the Oregon bankruptcy courts sponsored "Mediation Month."³⁵ Although not all bankruptcy courts have court-annexed mediation programs, mediation is available in any bankruptcy court on an ad hoc basis.³⁶ Since 1986, mediation has gained in acceptance and popularity, taking a prominent position in the bankruptcy world. In fact, as of 1995, twelve bankruptcy courts had court-annexed ADR programs.³⁷

Under the leadership of Judge Lifland, the Bankruptcy Court for the Southern District of New York developed a court-annexed mediation program to expedite its bankruptcy proceedings.³⁸ The Macy's case was

³³ The district court initiated a court-annexed mediation project on October 1, 1989. After favorable receipt by members of the bar, the district court's bankruptcy judges unanimously voted to adopt the mediation project throughout the district. *See* Lomax, *supra* note 16, at 70. Since then, the district court's mediation program has enjoyed much success. Of the 115 matters sent to mediation from October 1989 through July 1993, 57 were completely or partially settled, 30 were not resolved, 22 were dismissed or converted prior to completion of mediation, and 6 were pending. *See* NORTON, *supra* note 16, § 146:2.

³⁴ *See* Lomax, *supra* note 16, at 70.

³⁵ *See* Sandman, *supra* note 28, at 26. During Mediation Month, the court assigned 40 matters to mediation. *See id.*

³⁶ *See* NORTON, *supra* note 16, § 146:2. Several bankruptcy courts significantly use ADR on an ad hoc basis, including the District of New Jersey, the Southern District of Ohio, the Eastern District of Wisconsin, the Northern District of Texas, the Southern District of Texas, and the Western District of Texas. *See* Mabey et al., *supra* note 15, at 1314, 1328 n.202.

³⁷ *See* Mabey et al., *supra* note 15, at 1266. The 12 districts are the Northern District of Alabama, the Northern District of California, the Central District of California, the Southern District of California, the Middle District of Florida, the Southern District of Florida, the Northern District of Indiana, the Southern District of New York, the Western District of Oklahoma, the District of Oregon, the Eastern District of Pennsylvania, and the Eastern District of Virginia. *See id.* at 1315.

³⁸ *See* Karen Donovan, *Macy's Mediation Signals New Push on Reorganizations*, NAT'L L.J., Mar. 7, 1994, at 21. The ADR process in the Southern District of New York began in November 1993. *See* Cecilia Morris, *Why and How Mediation Works in the Southern District of New York*, Bankr. Ct. Dec. (CRR), Feb. 20, 1996, at A1. By developing a court-annexed mediation program for the district, one bankruptcy attorney has said that Judge Lifland "institutionalized a method that bankruptcy courts around the country have been turning to more frequently in an attempt to push cases forward." Donovan, *supra*, at 21.

one of the first referrals to the district's program.³⁹ In fact, the district was one of the first bankruptcy courts to implement a court-annexed mediation program for cases that did not involve a governmental entity.⁴⁰ Although the use of mediation is becoming more common in bankruptcy cases, the mediation of the actual reorganization plan, as Judge Lifland ordered in the Macy's case, is somewhat controversial.⁴¹

The controversy surrounding mediation's use to formulate reorganization plans revolves around two main concerns—that estates lack the necessary funding to compensate mediators and that mediators add little to an already difficult process. Harvey Miller, a leading bankruptcy attorney, argues that using mediation to formulate reorganization plans is “impermissible” and “absolutely shocking.”⁴² Miller states that the Bankruptcy Code does not permit paying third parties for mediation services and that the practice might not result in long-term savings.⁴³ In addition to cost concerns, Miller claims that most mediators “don't bring much to the table.”⁴⁴ U.S. Bankruptcy Court Judge Conrad B. Duberstein, Chief Judge in the District Court for the Eastern District of New York, agrees that estates lack the money to pay mediators.⁴⁵ Another attorney fears that although mediation brings parties closer together, the process adds another layer to already difficult negotiations.⁴⁶ Despite this controversy, courts continue to recognize the overriding benefits mediation offers Chapter 11 cases and many have begun to use mediation to formulate consensual reorganization plans.⁴⁷

³⁹ Although the appointment of a mediator in the Macy's case was one of the first uses of a mediator under the district's court-annexed mediation program, the court had appointed mediators on an ad hoc basis in other cases. *See* Mabey et al., *supra* note 15, at 1282, 1313 n.64.

⁴⁰ *See* DiDomenico, *supra* note 25, at 1.

⁴¹ *See* Donovan, *supra* note 38, at 21.

⁴² Franklin, *supra* note 7, at 5. Miller is a member of Weil, Gotshal & Manges in New York City. *See id.* Weil, Gotshal & Manges is a law firm with the country's largest bankruptcy practice. *See* Weil, Gotshal & Manges, *New York Practice: Business Finance & Restructuring* (visited Oct. 20, 1998) <<http://www.weil.com/wgm/wgmhomep.nsf/frameset/WGM+Practice+Area>>.

⁴³ *See* Franklin, *supra* note 7, at 5.

⁴⁴ *Id.*

⁴⁵ *See id.* However, Judge Duberstein admits that mediators can be helpful in valuation hearings and in weighing competing reorganization plans. *See id.*

⁴⁶ *See id.*

⁴⁷ *See* Atlas, *Part I*, *supra* note 30, at 40; *see also infra* Part III (detailing the advantages of mediation in bankruptcy and countering the perceived disadvantages).

Under the district's program, a matter can be sent to mediation in one of four ways: by referral from the bankruptcy judge assigned to the matter, by motion made by one of the parties, by motion made by the U.S. Trustee, or by a stipulation of the court.⁴⁸ Upon referral, the parties have seven days to choose a mediator from the district court's Register of Certified Mediators.⁴⁹ Mediators must be certified by the Chief Judge and need not be attorneys.⁵⁰ While some mediators are compensated for their services, other mediators serve on a pro bono basis.⁵¹ The mediator's duties generally involve controlling the procedural aspects of the mediation⁵² and filing a final written report of the outcome.⁵³

The district's mediation program is designed to reduce the caseload, control costs, and expedite the resolution of cases.⁵⁴ Judge Lifland asserts,

⁴⁸ See DiDomenico, *supra* note 25, at 35.

⁴⁹ See *id.* If the parties fail to select a mediator within seven days, the court selects a mediator. See *id.* The district's Register of Certified Mediators was released on February 18, 1994. During that week, 30 of the mediators attended two days of training set up by Judge Lifland. See Donovan, *supra* note 38, at 21.

⁵⁰ The district allows nonlawyer professionals to serve as mediators when "specialized expertise would assist in resolving the matter." DiDomenico, *supra* note 25, at 35. These mediators include accountants, real estate brokers, engineers, and investments bankers who meet the district's requirements, which include at least four years of professional experience. See *id.* A mediator who has expertise in a particular field or area of law "can question the parties and counsel in a way which promotes a negotiated settlement." Morris, *supra* note 38, at A9.

⁵¹ See DiDomenico, *supra* note 25, at 35. As of 1996, there were 180 paid mediators and 65 pro bono mediators on the district's Registry. See Dominic Bencivenga, *Warring Parties Forced to Focus on Resolution*, N.Y.L.J., May 9, 1996, at 5.

⁵² See DiDomenico, *supra* note 25, at 35. A mediator must decide how many sessions to hold and whether the party must attend the particular session. See *id.*

⁵³ See *id.* The mediator does not report the reasons for the result, thereby preserving the confidentiality of the mediation process. See *id.* While Federal Rule of Evidence 408 is applicable to mediation proceedings in the district court, the mediator is required to report any failure to cooperate by either counsel or party to determine whether sanctions are necessary. See *id.* Federal Rule of Evidence 408 reads in relevant part that "evidence of conduct or statements made in compromise or negotiations is likewise not admissible." FED. R. EVID. 408. In addition to Rule 408 protection, some courts enter general orders that establish the privileged nature of mediation proceedings. See Hon. Nancy F. Atlas, *Mediation in Bankruptcy Cases (Part II)*, PRAC. LAW., Oct. 1995, at 63, 72 [hereinafter Atlas, *Part II*]. For a discussion of Rule 408's alleged inadequacy to preserve the confidentiality of mediation proceedings and the resulting need for a general order, see *id.*

⁵⁴ See Bencivenga, *supra* note 51, at 5.

"There is no downside [to the district's mediation program] Mediators test the resolve of the parties and act as facilitators. . . . If there is no resolution, [the parties] can resort to traditional litigation."⁵⁵ Since the implementation of the court-annexed program in 1993,⁵⁶ approximately 250 cases have been submitted to mediation.⁵⁷ Notably, the majority of those cases in which mediation was completed were successfully resolved.⁵⁸ The district's program thus illustrates that mediation is a valuable and legitimate tool in the bankruptcy world.

III. THE DEBATE OVER THE USE OF MEDIATION IN BANKRUPTCY

ADR provides several benefits to Chapter 11 debtors and creditors. In sum, mediation reduces the hostility between the parties, maintains the parties' rights under the Bankruptcy Code and Rules, gives the parties control throughout the process, allows flexibility in decisionmaking, encourages open discussion, equalizes the parties' negotiating grounds, and reduces the resources spent on developing the reorganization plan. Although mediation offers many benefits to Chapter 11 parties, criticism exists as to mediation's use in bankruptcy proceedings. Common criticisms include that mediation is ineffective in complex cases, may prejudice the judge when the process is unsuccessful, is worthless in light of the fact that ninety percent of cases settle, and reduces the need for attorneys. Despite this criticism, mediation has become an important and useful tool for parties in Chapter 11 cases.

A. *Advantages of Mediation in Bankruptcy Proceedings*

Although the propriety of using mediation to formulate the reorganization plan itself is controversial,⁵⁹ mediation can serve a vital role

⁵⁵ *Id.*

⁵⁶ *See id.*

⁵⁷ *See* DiDomenico, *supra* note 25, at 35. The district expects the number of cases submitted to mediation to dramatically increase as parties realize they can avoid lengthy litigation that significantly increases the cost of a suit. *See* Bencivenga, *supra* note 51, at 5. Notably, from 1989 through 1992, professional fees stemming from bankruptcy proceedings in the district amounted to nearly \$770 million, more than any other district in the nation. *See* Edward A. Adams, *Bankruptcy Fees Here Are Highest in Nation: Totals Attributed to Cases' Size, Complexity*, N.Y.L.J., June 24, 1993, at 1.

⁵⁸ *See* DiDomenico, *supra* note 25, at 35.

⁵⁹ *See supra* Part II.B.

in Chapter 11 cases. For instance, mediation is valuable because it reduces hostility,⁶⁰ which is important because the debtor needs to foster and maintain working relationships with its creditors since the debtor's ultimate goal is reorganization.⁶¹

Additionally, mediation does not alter the duties or rights of any party under the Bankruptcy Code or Bankruptcy Rules.⁶² The parties also retain control of the process, which ideally results in a consensual resolution.⁶³ Because parties are not bound by the results of mediation, they may be more cooperative and feel more in control. Parties may feel more supportive of the outcome because the result is not forced upon them.⁶⁴ Parties also appreciate that solutions can be achieved that are suited to their needs,⁶⁵ which illustrates mediation's flexibility.

Furthermore, mediation encourages fair and open discussion. Because mediators are not bound by procedural and evidentiary rules, parties can discuss peripheral issues that might expedite a settlement.⁶⁶ Also, open discussion is encouraged because of mediation's confidentiality.⁶⁷ In addition, a mediator puts the parties on equal negotiating grounds,⁶⁸ which

⁶⁰ See Bedikian, *supra* note 2, at 26.

⁶¹ See *id.*; see also GROSS, *supra* note 5, at 134 (noting how ADR can help improve a debtor's relationships with its creditors).

⁶² See Atlas, *Part II*, *supra* note 53, at 70. Although parties might be required to participate in mediation, they are not required to accept a settlement nor do they lose their right to litigate if the mediation is unsuccessful. See Bencivenga, *supra* note 51, at 5.

⁶³ See Bedikian, *supra* note 2, at 25–26; see also Atlas, *Part I*, *supra* note 30, at 40 (recognizing a party's desire to control the way the dispute is resolved).

⁶⁴ See Lomax, *supra* note 16, at 70 (noting the importance of the parties' roles in negotiating the decision).

⁶⁵ See *id.*; see also Morris, *supra* note 38, at A1. An example of a solution that illustrates mediation's flexibility is as follows:

[O]ne mediator suggested that a debtor agree voluntarily to reinstate a disputed debt and that the creditor agree that fraud not show on the credit report. Both parties avoided an unacceptable risk they could not have avoided at trial: the debtor of an even poorer credit record, the creditor of getting nothing.

HARTWELL, *supra* note 32, at 31. In addition to allowing for flexible solutions, mediation also allows parties to choose where and when they meet. See *id.*

⁶⁶ See Morris, *supra* note 38, at A8 (explaining that peripheral issues include nonlegal matters that would not be the subject of a court ruling).

⁶⁷ See *supra* Part II.B.

⁶⁸ A mediator is sometimes necessary to decrease the animosity between the parties. As one commentator has noted:

encourages open discussion and increases the likelihood of successful mediation.

Most importantly, mediation in Chapter 11 cases achieves a more efficient resolution of disputes⁶⁹ than traditional litigation and reconciles differing positions as to the reorganization plan.⁷⁰ Mediation is nonbinding, introduces rationality into the process, and avoids the unnecessary expense of protracted litigation.⁷¹ Mediation also reduces the time spent on discovery and depositions,⁷² thereby significantly decreasing the cost of reorganization. Another significant cost factor is that parties might not spend as much time and money preparing for mediation sessions because the parties rather than the mediator ultimately decide the outcome.⁷³ In addition, mediation lessens the burden placed on the courts' dockets.⁷⁴

Inflated egos create the need for an authority figure to impose civility into what has become an uncivil situation When a mediator is appointed in a multiparty bankruptcy case, the first step is often a "come to Jesus" meeting among all the parties. These meetings usually are different from the multiparty meetings that have preceded them in only one respect. Everyone says "Yes sir" or "Yes ma'am" to the mediator, and the heavyweight bullies from the prior meetings become models of decorum.

Hugh Ray, *Mediators, Egos and Common Courtesy*, TEX. LAW., Mar. 14, 1994, at 22, quoted in Carole Silver, *Models of Quality for Third Parties in Alternative Dispute Resolution*, 12 OHIO ST. J. ON DISP. RESOL. 37, 68 (1996).

⁶⁹ Not surprisingly, the speed with which bankruptcy cases are handled is a concern. One author comments that "ADR makes great sense because corporate reorganization will be severely hampered if thousands of lawsuits cannot be resolved speedily." Francis Flaherty, *To Streamline a Bankruptcy, Try Using ADR*, 10 ALTERNATIVES TO HIGH COST LITIG. 113, 120 (1992); see also GROSS, *supra* note 5, at 178 (noting that mediation can save both time and money).

⁷⁰ See Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431, 436 (1995); see also Franklin, *supra* note 7, at 5; Kraemer & Rice, *supra* note 3, at 7; Sloan, *supra* note 12, at D3 (noting that "[a]nything that makes bankruptcy quicker and less litigious has to be an improvement").

⁷¹ See Miller, *supra* note 70, at 436; see also GROSS, *supra* note 5, at 121 (noting that mediation can reduce costs and litigation); Bencivenga, *supra* note 51, at 5 (explaining that "mediation provides a neutral party to apply reason and persuasion to negotiating voluntary deals between debtors and creditors").

⁷² See Bencivenga, *supra* note 51, at 5.

⁷³ See Lomax, *supra* note 16, at 70.

⁷⁴ See Miller, *supra* note 70, at 438 (explaining that by offering the potential for the efficient resolution of disputes and expediting reorganization cases, the burden

With all of these advantages, mediation may serve debtors, creditors, and the legal system better than traditional litigation in Chapter 11 cases.

B. Responses to the Perceived Disadvantages of Mediation in Bankruptcy

Critics claim that mediation is ineffective in complex, multiparty cases⁷⁵ or in Chapter 11 reorganization.⁷⁶ To the contrary, mediation is a valuable case management tool that is effective in multiparty disputes and reorganization cases.⁷⁷ Mediation serves a vital role in even the most complicated cases by restoring rationality, maintaining communication, and avoiding litigation.⁷⁸ Mediation in multiparty suits is particularly effective because it allows each creditor the opportunity to be heard and to pool resources with other creditors.⁷⁹

Still, others worry that although mediation proceedings are meant to remain confidential, a mediator might tell a judge that parties were unreasonable during negotiations and thereby prejudice the judge when mediation proves unsuccessful.⁸⁰ However, in general, communications made during mediation are privileged and confidential.⁸¹ Confidentiality serves the important role of encouraging frank and open discussion.

placed on the court is lessened); *see also* GROSS, *supra* note 5, at 178, 247 (explaining how mediation can free up scarce judicial time).

⁷⁵ *See* Edward A. Morse, *Mediation in Debtor/Creditor Relationships*, 20 U. MICH. J.L. REFORM 587, 593 (1987) (noting that as the number of parties increases, “the complexity of the dispute and the opportunity for misunderstanding multiply, thus erecting greater barriers for the mediator to help the parties overcome”); Bencivenga, *supra* note 51, at 5 (arguing that mediation is less effective in multimillion dollar cases involving many parties that have their own individual economic interests at stake).

⁷⁶ Harvey R. Miller of Weil, Gotshal & Manges called the idea of using ADR to formulate a reorganization plan “absolutely shocking” and “impermissible.” Franklin, *supra* note 7, at 5.

⁷⁷ *See* Miller, *supra* note 70, at 438.

⁷⁸ *See* Bencivenga, *supra* note 51, at 5. In addition, a mediator can “serve as a ‘preview of what a judge might do’ and indicate whether parties are acting reasonably.” *Id.* (quoting an interview with Richard S. Toder, partner at Zalkin, Rodin & Goodman LLP).

⁷⁹ *See* Bedikian, *supra* note 2, at 26.

⁸⁰ *See* Bencivenga, *supra* note 51, at 5.

⁸¹ *See* Atlas, *Part I*, *supra* note 30, at 47. One should consult local rules governing the privileged and confidential nature of communications made during mediation sessions. *See id.* In the Southern District of New York, confidentiality is stressed during mediator training. *See* Morris, *supra* note 38, at A9. Also, because Federal Rule of

Additionally, some attorneys view mediation as worthless because ninety percent of their cases settle without mediation.⁸² Even so, bankruptcy attorneys must look at their cases to determine when a settlement agreement is generally reached. Settlement often occurs after spending many hours working on oral and written presentations that are never even used in the litigation process.⁸³ If settlement is the client's main goal, mediation is a better tool than litigation.⁸⁴

Furthermore, attorneys worry that if mediation causes cases to settle earlier than in litigation, attorneys will experience a decrease in business.⁸⁵ Ideally, attorneys should be concerned with making the system work better for their clients and not with making more money from their clients. In the end, "[i]f we use the right tools for the job and use them with skill, we can expect our clients to prefer our services over those professionals who do not."⁸⁶ In other words, if attorneys use mediation successfully, clients will return.⁸⁷ Also, attorneys need not worry that their clients will have no use for them if mediation is utilized. The attorney's role is often vital to the mediation process because advocacy and negotiating skills can be as important in mediation as in litigation.⁸⁸

Evidence 408 applies to mediation proceedings, statements made during mediation are confidential. *See* DiDomenico, *supra* note 25, at 35.

⁸² *See* Sandman, *supra* note 28, at 26.

⁸³ *See id.*

⁸⁴ *See id.* (noting that mediation produces settlement as its main product whereas litigation produces settlement as a by-product).

⁸⁵ *See id.* The following illustrates the danger of this type of argument:

IBM's executives refused to introduce personal computers to their major customers because they believed that doing so would cut into IBM's lucrative mainframe business. The adverse consequences of this strategy are well known. In the free market, one cannot successfully hold onto business by refusing to use new, better technology and by charging more for the resulting inefficiency. If a lawyer or client believes that mediation can reach settlement goals faster, less expensively, and better than alternatives such as litigation, the lawyer that refuses to use the technology faces obvious risks.

Id.

⁸⁶ *Id.*

⁸⁷ According to one author, "[t]hose who take advantage of this opportunity [using mediation in bankruptcy] will benefit their clients, improve client relations and achieve a competitive advantage." *Id.* at 37.

⁸⁸ *See id.* at 27. Advocacy is not used to persuade the mediator but rather the other party. The mediating sessions give the attorney an opportunity to show his advocacy skills that will be used in court if no settlement is reached. Such an opportunity is an

Although criticism exists as to mediation's use in the mega-Chapter 11 case, the advantages far outweigh any claimed disadvantages. Mediation provides a flexible, rational means to achieving solutions devised to parties' individual interests. A free, open, hostile-free environment is established where parties maintain ownership in the process and embrace confidentiality. As a result, reorganization plans are formulated in a more efficient manner than in traditional litigation, certainly a desirable benefit in light of today's overcrowded bankruptcy dockets.

IV. STRIVING FOR A MIRACLE—USING MEDIATION TO FORMULATE MACY'S REORGANIZATION PLAN

On January 27, 1992 Macy's and eighty-eight of its subsidiaries filed for Chapter 11 protection.⁸⁹ Macy's, one of the nation's largest department store operators,⁹⁰ had \$200,000 in cash, but more than \$5 billion in liabilities.⁹¹ Macy's operated 251 department stores throughout the nation, employed more than 69,000 people, and purchased from more than 20,000 suppliers.⁹² Despite annual sales of over \$7 billion dollars⁹³ and greater revenues per square foot of retail space than almost all of its competitors, a mid-1980s leveraged buyout that changed Macy's from a publicly-held company to a privately-held company "created a cost structure unsustainable during an economic downturn."⁹⁴ Macy's entered Chapter 11 determined to emerge reorganized and independent.⁹⁵

invaluable attribute of the mediation process and increases the likelihood of settlement. *See id.*

⁸⁹ *See In re R.H. Macy & Co.*, 152 B.R. 869, 870-871 (Bankr. S.D.N.Y. 1993).

⁹⁰ *See id.*

⁹¹ *See* Jeff Siegel, *Judge Gives Blessing to Macy-Federated Marriage*, WOMEN'S WEAR DAILY, Dec. 9, 1994, available in 1994 WL 3057205, at *2. Macy's had \$4.95 billion in assets at that time. *See* Anne Veigle & Eric Fisher, *How Macy's Boss Fell—and Avoiding His Fate*, WASH. TIMES, Jan. 27, 1997, at D26 (book review), available in 1997 WL 3662252.

⁹² *See* Arnopol, *supra* note 6, at 134-135.

⁹³ *See id.* at 135.

⁹⁴ Susan S. Fainstein & Ann Markusen, *The Urban Policy Challenge: Integrating Across Social and Economic Development Policy*, 71 N.C. L. REV. 1463, 1481 (1993). As a result of the buyout, Macy's suffered net losses of more than \$620 million between 1987 and 1991. *See* R.H. Macy, *Plans of Reorganization*, *supra* note 9. The leveraged buyout in 1986 was one of many factors that contributed to Macy's bankruptcy filing. Other factors included the failure of Macy's private label lines to live up to expectation, lavish expense accounts for even those at the divisional level, fierce competition from

A. Mediating Macy's Reorganization

Nearly two years after filing for Chapter 11 protection, Macy's still did not have a confirmed reorganization plan.⁹⁶ In February 1994 Judge Lifland "anticipated that the parties in interest were about to engage in difficult and potentially explosive negotiations as to a plan that might have engendered the onset of litigation."⁹⁷ As a result, Judge Lifland appointed a mediator to remove the case from the "court's clutches" and develop a consensual reorganization plan.⁹⁸ Judge Lifland appointed former Secretary of State Cyrus Vance⁹⁹ to mediate the negotiations¹⁰⁰ and ordered Macy's to submit a proposed reorganization plan to Vance by March 8, 1994.¹⁰¹ The appointment of a mediator surprised the bankruptcy world.¹⁰²

The biggest obstacle to the success of Macy's reorganization plan was Federated Department Stores, Inc. (Federated). Federated wanted to merge

rival department stores, crushing debt, and weak sales. For a comprehensive account of what led Macy's to file for Chapter 11 protection, see TRACHTENBERG, *supra* note 13.

⁹⁵ See Moin & Wilner, *supra* note 11, at 2.

⁹⁶ After two years, the Macy's case was nowhere near settlement despite accumulating \$37.9 million in professional fees. See Donovan, *supra* note 38, at 21.

⁹⁷ Miller, *supra* note 70, at 437.

⁹⁸ See Mabey et al., *supra* note 15, at 1282; see also Miller, *supra* note 70, at 437.

⁹⁹ Vance is a member of the law firm of Simpson, Thacher & Bartlett. See Sloan, *supra* note 12, at D3. Vance negotiated for peace in Vietnam, South Africa, and Bosnia and helped resolve the Olympia & York real estate bankruptcy case in 1993. Despite Vance's negotiating experience, some criticized his appointment. According to retail consultant Alan Millstein, "[i]t'll make Bosnia look pretty." See Ellen Neuborne, *Macy to Test Vance's Skills: Diplomat Must Get Retailer, Creditors to Agree*, USA TODAY, Mar. 23, 1994, at 4B. One attorney commented, "I hope he does better here than he did in Bosnia." TRACHTENBERG, *supra* note 13, at 230.

¹⁰⁰ See TRACHTENBERG, *supra* note 13, at 229.

¹⁰¹ See Stephanie Strom, *Vance Named to Mediate Macy's Reorganization*, L.A. DAILY NEWS, Feb. 23, 1994, at 1, available in 1994 WL 5109021. Macy's exclusive right to file a final reorganization plan expired on August 1, 1994. See Moin & Wilner, *supra* note 11, at 2. Although Macy's had an exclusive right to file a plan by this day, creditors could submit less detailed plans to Vance upon request. See Shelly Reese, *Federated Gets OK to Sell Merger Plan*, CIN. ENQUIRER, Apr. 16, 1994, at B5; *Macy's, Federated Offering Plans to Exit Bankruptcy*, PLAIN DEALER (Cleveland), May 10, 1994, at 3C.

¹⁰² For a discussion of the controversy surrounding the use of mediation to formulate reorganization plans, see *supra* Part II.B. Before this time, courts rarely turned to mediation to formulate a reorganization plan. See Donovan, *supra* note 38, at 21.

with Macy's. In an attempt to realize this goal, Federated became one of Macy's largest creditors by purchasing approximately \$500 million in secured mortgage debt¹⁰³ in late December 1993.¹⁰⁴ Federated planned to acquire Macy's by virtue of its creditor status, but Macy's still vowed to emerge from Chapter 11 as an independent company.¹⁰⁵

While Macy's tried to formulate a reorganization plan to meet deadlines set by Judge Lifland and Vance, Federated loomed over its head. Federated wanted to discuss a merger with Macy's creditors, but Macy's insisted it would remain independent. Vance met with Federated in March 1994 and asked the company to refrain from submitting competing plans, thereby allowing Macy's to negotiate with other creditors. Federated agreed to work within the mediation process¹⁰⁶ but later obtained permission to approach other creditors about a possible Federated-Macy's merger.¹⁰⁷

As of June 14, 1994, Macy's still wanted to emerge from Chapter 11 as an independent company, but did begin to engage in merger discussions with Federated.¹⁰⁸ These negotiations were a clear sign that mediation was working. During merger discussions, mediation's flexibility allowed Vance's role to be altered to allow for more direct talks between creditors and between Macy's and its creditors.¹⁰⁹ For several weeks, Macy's

¹⁰³ See TRACHTENBERG, *supra* note 13, at 226 (noting that the amount was nearly half of Prudential's \$1 billion claim); Ezra G. Levin & Kenneth H. Eckstein, *The Acquisition of Troubled Companies*, in CORPORATE MERGERS AND ACQUISITIONS 23, 33-34 (ALI-ABA Course of Study Materials No. C115, 1995); Sloan, *supra* note 12, at D3. Federated purchased the debt from Prudential Life Insurance Co. of America. See Karen Donovan, *Macy Merger Squeezes Out Weil Gotshal; Bankruptcy Judge Approves Federated's Takeover Plan*, NAT'L L.J., Dec. 19, 1994, at A6. By purchasing a large portion of Macy's debt, Federated hoped to move closer to its goal of merging with Macy's. See Neuborne, *supra* note 99, at 4B.

¹⁰⁴ See TRACHTENBERG, *supra* note 13, at 226 (noting that the purchase occurred late on New Year's Eve). Federated then announced in January 1994 that it "hoped to use its creditor status to take control of Macy's." Sloan, *supra* note 12, at D3.

¹⁰⁵ See Moin & Wilner, *supra* note 11, at 2.

¹⁰⁶ See *Macy's Gets Breathing Room to Pitch Plan to Creditors*, WALL ST. J., Mar. 25, 1994, at A4.

¹⁰⁷ See Reese, *supra* note 101, at B5.

¹⁰⁸ See Moin & Wilner, *supra* note 11, at 2.

¹⁰⁹ See David Moin & Rich Wilner, *Questrom to Pitch Proposal to Macy's Board of Directors Today*, DAILY NEWS REC. (New York), July 1, 1994, at 2 (noting that Vance had not met with any party in more than a month but had kept informed of negotiations through his attorneys). One source close to the mediation process said that

management engaged in "listening sessions" with Federated, dismissing the importance of the meetings as merely meeting their fiduciary duties during bankruptcy.¹¹⁰ However, on July 1, 1994, Macy's and Federated met to engage in serious discussions concerning a possible merger.¹¹¹ After much discussion, on July 14, 1994 Macy's agreed to a merger with Federated.¹¹²

Although Macy's agreed to merge with Federated, the joint reorganization plan¹¹³ required the approval of other creditors.¹¹⁴ Remarkably, the plan satisfied almost everyone.¹¹⁵ Vance was able to "bridge[] the gap between rival creditor groups, . . . meet with each, gauge their demands, and then shuffle between separate camps attempting to find common ground."¹¹⁶ Macy's creditors voted unanimously to approve the reorganization plan. The plan gave creditors approximately \$4.1 billion for \$6 billion in claims, which was \$2 billion more than initial estimates.¹¹⁷ Furthermore, shareholders also approved the plan.¹¹⁸ Macy's had been in Chapter 11 since January 27, 1992 and emerged approximately 1046 days later. According to Harvey Miller of Weil, Gotshal & Manges, those 1046

although Vance's exact role was in question, his presence aided in settling disputes. *See id.*

¹¹⁰ *See id.*

¹¹¹ *See id.*

¹¹² *See* Siegel, *supra* note 91, at *2.

¹¹³ For a detailed discussion of the reorganization plan, see *infra* notes 121-131 and accompanying text. *See also* R.H. Macy, *Plan of Reorganization*, *supra* note 9; R.H. Macy & Co., Inc., *Amended Joint Plan of Reorganization*, The Bankruptcy Datasource, Sept. 15, 1994, available in 1994 WL 527608; R.H. Macy & Co., Inc., *Second Amended Joint Plan of Reorganization*, The Bankruptcy Datasource, Nov. 15, 1994, available in 1994 WL 663281.

¹¹⁴ Although creditors generally must approve a reorganization plan, Judge Lifland had the power to change or impose a plan over creditor objection. *See Macy Has Dissent on Board*, J. REC. (Oklahoma City, Okla.), Apr. 20, 1994, at 1, available in 1994 WL 4951222.

¹¹⁵ Tom Shull, a former Macy's executive vice president, said that the mediation bridged the gaps between creditors in that "[e]ventually we were able to achieve a settlement that satisfied almost everyone, including the unsecured bondholders." TRACHTENBERG, *supra* note 13, at 230.

¹¹⁶ *Id.*

¹¹⁷ *See Notice of Conventional Filing of Final Report of Cyrus R. Vance, as Mediator, Pursuant to Standing Mediation Order and the Mediation Order Entered in the Macy's Reorganization Case*, Dec. 13, 1994, at *2, available in LEXIS, Bankruptcy Library, Macy File [hereinafter *Mediator's Report*]; TRACHTENBERG, *supra* note 13, at 227 (noting that by January 1992, the amount had increased to \$3.2 billion).

¹¹⁸ *See* Siegel, *supra* note 91, at *2.

days were time well spent because “[w]e witnessed the survival of a New York institution—R.H. Macy.”¹¹⁹

B. Results of Macy's Mediation

In December 1994, thirty-five months after Macy's filed for Chapter 11 protection and only eight months after Vance's appointment, Judge Lifland confirmed the joint reorganization plan submitted by Macy's and Federated. Although Macy's failed to emerge from Chapter 11 independent, it did emerge reorganized. The merger of Macy's and Federated resulted in the nation's largest department store chain¹²⁰ and the sixth largest retailer¹²¹ with 335 stores and annual sales of more than \$14 billion. Additionally, Macy's creditors, who held approximately \$6 billion in claims, received \$4.1 billion.

As part of Macy's reorganization plan, various claims would be submitted for arbitration or mediation under an ADR program administered by the American Arbitration Association (AAA).¹²² The U.S. Bankruptcy Court for the Southern District of New York approved the ADR program in 1995 by noting that this program is “in the best interest[s] of the reorganized debtors, its claimants and other parties in interest.”¹²³ Under the program, claims are divided into the following three classes: class A claims (under \$100,000), class B claims (\$100,000 to \$500,000), and class

¹¹⁹ *Id.* Miller, the lead bankruptcy attorney at Weil, Gotshal, played an intimate role in Macy's reorganization. See TRACHTENBERG, *supra* note 13, at 204.

¹²⁰ See Siegel, *supra* note 91, at *2.

¹²¹ See TRACHTENBERG, *supra* note 13, at 232. The merged company ranks behind Wal-Mart; Kmart; Sears, Roebuck & Co.; JCPenney Co.; and Dayton Hudson Corp. In the New York metropolitan area alone, the company operates 39 stores, including Stern's, Macy's, and Bloomingdale's. See *id.*

¹²² See AAA Administers Macy's ADR Program, DISP. RESOL. J., Oct. 1996, at 5, 5. The program allows Macy's to avoid additional delay and expense and the intervention of the bankruptcy court in resolving claims. See *id.* Similar programs have been administered by the AAA for bankruptcy cases involving Eastern Airlines, Greyhound, St. Johnsbury Trucking, and LTV. See *id.* For a detailed description of the ADR procedure to be used for unresolved claims, see *Reorganized Debtors' Motion for an Order Approving Alternative Dispute Resolution Procedure for Claims and Adversary Proceedings and Authorizing Reorganized Debtors to Implement Alternative Dispute Resolution*, Nov. 10, 1995, available in LEXIS, Bankruptcy Library, Macy File; *Reorganized Debtors' Motion for an Order Approving Amendment to Alternative Dispute Resolution Procedure for All Unresolved Claims, Cure Disputes and Adversary Proceedings*, June 6, 1996, available in LEXIS, Bankruptcy Library, Macy File.

¹²³ AAA Administers Macy's ADR Program, *supra* note 122, at 5.

C claims (over \$500,000).¹²⁴ Unresolved class A and B claims proceed to arbitration, which is binding unless a claimant protests.¹²⁵ Mediation is mandatory, however, for unresolved class C claims. If mediation is unsuccessful, the claim proceeds to binding arbitration if both parties consent.¹²⁶

As required by the district's mediation program, Vance filed a final report.¹²⁷ In his report, Vance praised the mediation process because the plan was consensual;¹²⁸ creditors,¹²⁹ employees, and management¹³⁰ were fairly treated; and there was a significant cost savings.¹³¹ Vance stated that he is "convinced that mediation can and will facilitate the agreements that form the basis of the financial restructuring that must be at the core of any consensual reorganization. . . . [M]ediation . . . can do so in a way that reduces the costs and delays that are sometimes negatively associated with bankruptcy." ¹³²

Judge Lifland also noted that mediation expedited Macy's reorganization and saved millions of dollars in legal fees.¹³³ According to Judge Lifland, mediation "yielded a reorganization plan faster, less

¹²⁴ See *id.*

¹²⁵ See *id.*

¹²⁶ See *id.* If the parties do not consent to binding arbitration, the claim will be resolved by either a bankruptcy court or a district court. See *id.*

¹²⁷ See *Mediator's Report*, *supra* note 117, at *1.

¹²⁸ Vance commented that the plan "is supported by Macy's, by its creditors committee, by its bondholders committee, and by its financial institutional lenders. The merger has been approved by both the Federal and State governments. That is a remarkable testament to the terms of the plan." *Id.* at *2.

¹²⁹ Vance reported that:

The plan values the consideration to creditors as being \$4,122,000,000. This is in an environment where, I am told, that Macy's was valued at \$2.0 [billion] in July 1992, \$2.8 [billion] in July 1993 and \$3.2 [billion] in February 1994. This increase in value—of nearly \$1 [billion] since February—provides very fair treatment to Macy's creditors, which is an important goal of bankruptcy.

Id.

¹³⁰ Vance reported that 98–99% of Macy's employees would maintain their jobs. In addition, all severance contracts of managers who chose to leave are being honored. See *id.* at *1–*2.

¹³¹ Vance estimated that at least \$30 million in legal fees were saved by using mediation. See *id.* at *2. Vance also noted that bankruptcy reorganizations are important to the economy because reorganization maintains companies and preserves jobs. See *id.*

¹³² *Id.* at *3.

¹³³ See Sandman, *supra* note 28, at 37.

expensively, and better than the usual litigation/negotiation method.”¹³⁴ After spending seven years resolving LTV’s Chapter 11 case, the Macy’s experience confirmed the district court’s belief that mediation serves parties and the bankruptcy system better than traditional litigation and plays an important role in even the most complex Chapter 11 cases.¹³⁵

V. CONCLUSION

While the debate over using mediation to formulate reorganization plans continues, mediation’s use in Chapter 11 proceedings gains in popularity. The success of Macy’s mediation will likely prompt other courts to take advantage of mediation in even the most complex Chapter 11 cases. Bankruptcy courts will undoubtedly continue to use mediation either through a court-annexed mediation program or on an ad hoc basis. The continued and increased use of mediation in bankruptcy cases shows that judges, lawyers, and businesses are attuned to the benefits—perhaps even miracles—mediation offers.

Macy’s received its miracle because it survived Chapter 11 reorganization. Despite merging with Federated, the Macy’s name still abounds. Stores remain open so that loyal patrons, young and old alike, can shop their favorite store. In fact, Macy’s “Thanksgiving Day parade still delights millions. And Macy’s Herald Square, open for business seven days a week, is still the biggest store in the world.”¹³⁶ The success of Macy’s shows that “[w]hether it is the multi-million dollar dispute or the garden variety type, ADR is a process whose time has come.”¹³⁷

¹³⁴ *Id.*

¹³⁵ *See id.*

¹³⁶ TRACHTENBERG, *supra* note 13, at 239.

¹³⁷ Bedikian, *supra* note 2, at 27.

